The most important skill of the CFO?

By Dr. Alex Gold, CEO of BWD North America, and Sten White, Strategy and Operations Associate, BWD North America

One would expect chief financial officers to be front-and-center in the sustainable finance revolution. After all, there is now mainstream acceptance that environmental, social, and governance (ESG) issues can impact financial performance. Given this, we were disappointed in a recent article by the CPA Journal - "The Many Skills of the CFO" - which didn't mention ESG or sustainability at all.

In this article, we explain how ESG is a critical contributor to the CFO's five roles as defined by the CPA Journal: financial steward, communicator of financial results, leader of financial planning and analysis, driver of internal controls and process improvements, and strategist.

Financial steward

What does this mean? A good CFO stewards the company's finances, considering all factors that can affect the balance sheet and long-term growth.

What would happen to financial stewardship if the CFO does not integrate ESG? If the CFO does not have a strong understanding of sustainability, the company will be blind to ESG considerations known to affect the balance sheet and long-term growth – think property damage from increasing extreme weather events, loss of customers from data privacy breaches, and sanctions related to human rights impacts.

Here's the reality - ESG factors can directly affect a company's revenues and expenses, its ability to attract new capital, and the recognized value of assets and liabilities on its balance sheet. The Task Force on Climate-Related Financial Disclosures (TCFD) cited a 2015 study that estimated the value at risk, as a result of climate change, to the total global stock of manageable assets as ranging from $4.2 trillion to $43 trillion between now and the end of the century. Broad investor support of the TCFD framework is clear, the Climate Action 100+ which consists of more than 500 institutional investors who represent more than USD$50 trillion AUM requests companies disclose on climate risks consistent with the framework.

Communicator of financial results

What does this mean? CFOs lead communications of financial data to investors on quarterly investor calls.

What would happen to the communication of financial results if the CFO does not integrate ESG? An important component of communicating financial results is providing commentary on performance and future outlook (IFRS Management Commentary or US GAAP Management Discussion and Analysis). A CFO without an understanding of ESG will not be able to communicate the complete picture. They will be unable to answer the increasing number of questions from investors about the company's ESG performance. They may also be unable to meet expectations of proposed regulation seeking attribution of financial statement line items to climate-related issues (such as the SEC-proposed climate-related financial disclosures).

Here's the reality - ESG factors are known to impact a company's profits and investment returns, and so it's no surprise that investors are asking about ESG on investor calls. Investors want to know that companies are focused on ESG issues material to their business, as this increases their chances of outperformance.

Leader of financial planning and analysis

What does this mean? A good CFO does not just take financial data at face value, they try to find what's driving changes in the numbers i.e., market conditions, supply chain costs.

What would happen to financial planning and analysis if the CFO does not integrate ESG? Without integrating ESG, a CFO might miss potential risks and opportunities that will affect the company's long-term viability to operate and make profits. For example, a consumer goods company that doesn't allocate capital towards R&D of use of recycled materials to produce their products might lose out on a growing market segment that is more conscious of material efficiency.

Here's the reality – Leading CFOs integrate ESG throughout financial planning and analysis activities such as budgeting, forecasting, valuations, capital expenditure, and capital allocation. Understanding the methods by which ESG impacts financial planning can help a CFO better manage risk and capture value creation opportunities.

Driver of internal controls and process improvements

What does this mean? The CFO is ultimately responsible for the integrity and accuracy of the financial data that is disclosed in public filings. In order to confidently disclose this data, the CFO must make sure there is a proper system of internal controls and solid process around data collection.

What would happen to internal controls and process improvements if the CFO does not integrate ESG? Regulators are starting to ask for more ESG information in financial filings. Non-credible and inaccurate ESG data that has not been collected through a proper system of internal controls can have legal and reputational impacts. Investors, employees, and customers are growing sensitive to greenwashing, however a global study found 58% of executives say their companies engage in greenwashing by exaggerating efforts to curb harm to the environment from their products, services or operations. Without proper oversight from the CFO, this practice can infiltrate companies and lead to regulatory enforcement, exclusion from investor funds, and stakeholder ridicule.

Here's the reality - The same integrity of data collection should be applied to ESG data collection, and who better to lend their expertise than the CFO? Assurance of ESG data is soon becoming commonplace and even a requirement: the EU Corporate Sustainability Reporting Directive is seeking to mandate sustainability assurance, and the SEC has recently proposed requiring assurance over greenhouse gas emissions data.

Strategist

What does this mean? Strategy involves long term thinking, understanding risks and opportunities, and knowing how to implement a plan that considers risks and leads to the most desired outcome.

What would happen to strategy if the CFO does not integrate ESG? If the CFO doesn't understand ESG, sustainability initiatives are always bound to be considered optional extras and not integrated into the company's value creation strategy. The CFO wouldn't have the knowledge to appreciate that sustainability is part of everyone's job and would expect the sustainability function to manage its initiatives on its own. Little progress would be made, as other functions would not be incentivized to support key risks or opportunities such as reducing product emissions or improving property resilience.

Here's the reality – Greenhouse gas emissions, water use, employee engagement, human rights, and most other ESG issues touch every part of a business in some way. The most successful examples of ESG-led corporate transformation have come from integrating sustainability into every employee's job and linking all employee bonuses to ESG goals. The ESG-aware CFO is at the center of these transformations, equipping business functions with resources to meet their ESG objectives and ensuring employees are incentivized appropriately.

Conclusion

The CFO without an understanding of ESG risks being left behind as business seeks to redefine itself as a positive contributor to environmental and social objectives. Investors, customers, and employees now expect companies and their management to consider sustainability in all facets of their business – it is no longer an optional extra. If you are just beginning to integrate ESG and sustainability into your role as CFO, some first steps you might consider are:

- Get up to speed with what's happening at the IFRS Foundation's International Sustainability Standards Board - which is working to create a global baseline of sustainability disclosure standards based on existing investor-focused guidance from the Sustainability Accounting Standards Board (SASB) and the Climate Disclosure Standards Board
- See what ESG topics are considered financially material to your industry using SASB's materiality finder and review how your company manages and reports on these issues
- Review materials on integrated reported and integrated thinking principles. The IFAC, AICPA and Integrated Reported published a particularly relevant piece on the CFO's role in value creation.
- Meet with your investors and hear what sustainability issues they think are priorities for your company, and how'd they'd like progress to be communicated
- Investigate assurance of your ESG data and reporting processes, which would be a requirement per the proposed EU Corporate Sustainability Reporting Directive and the proposed U.S. SEC climate-related reporting requirements